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DE RUEHSA #2069/01 1591202
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FM AMEMBASSY PRETORIA
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RUCPCIM/CIMS NTDB WASHDC
RUCPDC/DEPT OF COMMERCE WASHDC
RUEATRS/DEPARTMENT OF TREASURY WASHDC
RUEHJO/AMCONSUL JOHANNESBURG 6927
RUEHTN/AMCONSUL CAPE TOWN 4471
RUEH DU/AMCONSUL DURBAN 8920

UNCLAS SECTION 01 OF 03 PRETORIA 002069

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DEPT FOR AF/S/MTABLER-STONE; AF/EPS; EB/IFD/OMA
USDOC FOR 4510/ITA/MAC/AME/OA/DIEMOND
TREASURY FOR OAISA/RALYEA/CUSHMAN
USTR FOR COLEMAN

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E.O. 12958: N/A
TAGS: [ECON](#) [EFIN](#) [EINV](#) [ETRD](#) [EMIN](#) [EPET](#) [ENRG](#) [BEXP](#) [KTDB](#) [SENV](#)
PGOV, SF
SUBJECT: SOUTH AFRICA ECONOMIC NEWS WEEKLY NEWSLETTER JUNE 08, 2007
ISSUE

11. (U) Summary. This is Volume 7, issue 23 of U.S. Embassy Pretoria's South Africa Economic News Weekly Newsletter.

Topics of this week's newsletter are:

- Inflation Data Shocks Economists
 - Consumers Continue To Borrow
 - GDP Growth Slows To 4.7%
 - State Raises Offer As Strike Bites
 - Vehicle Sales Slow Down
 - The MPC Hikes Interest Rate
 - Green Tax On Sports Vehicles
- End Summary.

Inflation Data Shocks Economists

12. (U) Data released by Statistics South Africa (StatsSA) showed that South Africa's targeted CPIX inflation (consumer price inflation, excluding mortgage interest rates), quickened to 6.3% in the year to April, the highest rate in nearly four years and above the South African Reserve Bank's 3-6% target band. Local economists reacted with shock to the latest consumer inflation data. Reuters reports the data knocked government bonds and the rand currency, with the market further discounting an expected interest rate increase at the Reserve Bank's June 6-7 policy meeting. The rand weakened from R7.17/\$ to R7.19/\$ before the release, while yield on the short-dated R153 bond due in 2010 jumped to its highest level since December last year, a rise of 14 basis points to 8.3% on the day. The increase in CPIX inflation was underpinned by the large increase in fuel prices in April and the continued price pressure in the food component. Domestic fuel prices surged by 69c/litre in April following a significant weakening in the rand during March and a further strengthening in international crude oil prices, which exceeded \$60 per barrel in March. The rand oil price during March averaged R458/bl compared with R420/bl in February and less than R400/bl in January. Meanwhile, food prices have been negatively impacted by the drought and accelerated from 7.7% in March to 8.4% in April, driven by a 9.9% increase in grain prices and an 11.1% rise in meat prices. The inflation rate of dairy products and other food products also accelerated. (Fin24, May 30, 2007)

Consumers Continue To Borrow

13. (U) South African Reserve Bank data showed that private sector credit extension (PSCE) accelerated from 24.1% in March to 25.1% in April, above market expectations of 23.9%. Broad money supply (M3) also picked up, rising from 20% in March to 22.3% in April. Economists said a combination of these data and the inflation figures will lead the Reserve Bank to want to not only contain borrowing but to contain inflation expectations as well. Strong domestic demand has pushed household debt to a record 73.8% of disposable income in the fourth quarter last year, adding to inflationary pressures. (Business Day, May 31, 2007)

GDP Growth Slows To 4.7%

14. (U) According to Statistics South Africa (StatsSA) data, economic growth slowed to an annualized 4.7% in the first quarter of 2007, from 5.6% in the fourth quarter of 2006 and in line with expectations. Analysts said the growth, while slower, showed the economy remains on a solid footing. Strong financial services, manufacturing and retail activity, along with particularly vigorous construction activity, all served to sustain GDP growth. However, the mining and quarrying sector contracted by 7.8%. The construction industry was the star performer in the first quarter of 2007, growing by an annualized 21.3%, proof that the public sector's huge infrastructure spending program is getting off the ground. It was the 34th consecutive quarter of positive growth since 1998, although the impact of interest rate increases since June 2006 has brought the pace of growth down. Africa's biggest economy has expanded by around 5% a year for the past three years, largely due to robust consumer spending and global demand. (Fin 24, May 29, 2007)

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State Raises Offer As Strike Bites

15. (U) The South African government has tabled a new package for public servants in an attempt to end a strike that has nearly crippled government service delivery. The offer, which includes a wage increase of 6.5%, up from the previous offer of 6%, was rejected by unions. They want "substantial" across-the-board increases. Labor is demanding a 12% increase. The Department of Public Service and Administration said the 6.5% increase for the 2007-08 financial year took into account average projected CPIX (consumer inflation excluding mortgages) for the period plus a real salary increase. For 2008-09, the general salary increase would be CPIX plus 0.5%. The offer would cost R13.7billion (\$2 billion), an improvement from the R9.3 billion (\$1.3 billion) that was initially offered. The current total package for a level-one public servant is R69,282 (\$9,900) and in the new offer would be R76,122 (\$10,870). The government's offer also includes revised salary structures for the next four years as well as increases in certain allowances. However, union negotiators said they believed the offer to improve the total package over the next four years was too vague. Economists warned that above-inflation pay demands will definitely put pressure on inflation and could cancel out the benefit of wage increases. Meanwhile, the strike has already had an impact on the economy, with the education and health sectors the worst affected. (Business Day June 5, 2007)

Vehicle Sales Slow Down

16. (U) According to the National Association of Automobile Manufacturers of SA (NAAMSA), 51,683 vehicles were sold in May 2007, 1.7% lower than in May 2006. Analysts said last year's interest rate hikes, car price inflation and high personal debt have continued to put a damper on new vehicle purchases. NAAMSA said this was the first time in just less than four years that there had been a year-on-year decline in vehicle sales for four consecutive months. While only 31,490 passenger vehicles were sold in May 2007, 10% lower than the same month last year, robust economic activity

continued to drive demand for light commercial vehicles, with 16,904 units sold in May, 15.6% up on the May sales figures of last year. Strong private and public investment also helped medium and heavy trucks maintain momentum, with the two segments showing growth of 6.4% and 19%, respectively. "The strong investment cycle was expected to keep new commercial vehicle sales afloat," NAAMSA said. Finally, the 14,787 units exported in May 2007 were 4.9% above than the corresponding month last year. (Business Day, June 5, 2007)

The MPC Hikes Interest Rate

17. (U) Following two successive meetings of the South African Reserve Bank's Monetary Policy Committee (MPC) where interest rates were left unchanged, the MPC finally decided to adjust the repo rate upwards by 50 basis points. The repo rate was adjusted to 9.5%, which was in line with market expectations. Major commercial banks are expected to adjust the prime overdraft rate from 12.5% to 13%. High and volatile international oil prices, rising food prices, robust household consumption expenditure growth and deteriorating inflation expectations (aggravated by the ongoing strike) were signaling that a rate hike was in the pipeline. The deterioration was also evident in the bond market, where long-term yields have increased further. The MPC statement left the door open for further interest rate hikes as the MPC expressed its willingness to act in order to contain inflationary pressures and keep the inflation rate below 6%. With international oil prices still around \$70/bl, the rand still volatile and above R7 against the dollar, and food prices rising, the risk to higher interest rates on the back of higher inflation remains firmly on the upside. (ABSA Newsletter, June 7, 2007)

Green Tax On Sports Vehicles

18. (U) Department of Minerals and Energy (DME) Director of Energy Efficiency Dr. Elsa Du Toit reported that the DME is proposing to introduce a 33% tax on the selling price of large, petrol-consuming

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sports utility vehicles (SUV), and to double the annual license fees. Du Toit said the aim of imposing the green tax would be to mitigate environmental degradation impacts and to reduce fuel consumption by 12 percent by 2015. Ever-increasing fuel prices and escalating interest rates have not discouraged the South African middle class' robust appetite for big cars, which are regarded as heavy polluters. According to De Toit, reports show that SUVs consume double the amount of fuel compared to an ordinary sedan, while emitting 9,000 kg of carbon dioxide compared to 4,500 kg for lighter cars. Du Toit said market forces are not working, which makes it necessary to follow the global practice of imposing punitive measures to enforce behavioral change in people. If DME endorses this additional "energy efficiency levy," a vehicle that costs \$119,700 could have an additional tax of \$39,400, plus a 100 percent levy on annual license fees. Environmental activist groups welcome DME's proposal to establish the green tax, while automotive industry economists argue that the levy appears to be too steep and could put some jobs at risk. DME's comprehensive energy efficiency strategy targets energy consumption reductions in industrial, mining, power generation, commercial and public sector buildings by 15 percent, and transportation and residential sectors by nine and ten percent, respectively. DME intends to achieve these goals by promoting renewable energy alternatives, incentives and rebates. (Business Day and Pretoria News, May 23, 2007)

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